A SUBMISSION
TO
THE ROYAL COMMISSION ON ENERGY

CANADIAN PETROFINA LIMITED
MONTREAL, QUEBEC
JUNE, 1958.

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INTRODUCTION

This brief has been prepared at the request of the Royal Commission on Energy and expresses the views of Canadian Petrofina Limited concerning:—

1. Marketing of Western Canadian crude oil.

2. The National Energy Authority.

This submission will first outline our Company's operations and then deal with the two subjects in the above order.

Canadian Petrofina Limited markets petroleum products in the Maritime Provinces, Quebec, and Central and Eastern Ontario and operates a refinery at Montreal. The Company, together with its subsidiaries, Calvan Consolidated Oil & Gas Company Limited and Western Leaseholds Ltd., is engaged in exploration, development and production of Western Canadian crude oil. Crude oil production of our Group (before royalty) averaged approximately 9,000 barrels per day in 1957.

Control of the Company is in the hands of Petrofina, S.A. of Brussels, Belgium. However, all policies are determined in Canada by the Board of Directors and Management. In this connection, it should be pointed out that the Board of Directors is composed preponderantly of leading Canadian businessmen and Management is entirely Canadian.

Petrofina, S.A. and its subsidiaries and associated companies have, at present, no crude oil production of their own outside of Canada for which they require markets in this country. They do produce oil in Egypt, Venezuela, Angola, Mexico and the United States, but it is all used close to the source of production.

However, Petrofina, S.A. is committed by agreement to supply our requirements of crude oil and its transportation by ocean tankers. Canadian Petrofina may seek other sources of supply, but has to give Petrofina, S.A. the first right to supply its requirements on equal conditions. In other words, under this arrangement, our Company is guaranteed crude oil supplies and ocean transportation at competitive prices.

The bulk of our oil is purchased from a British oil company which has extensive production and reserves in the Persian Gulf area. The largest portion of the crude supplied to our refinery comes from Kuwait.

As mentioned earlier, Canadian Petrofina has substantial producing interests in Western Canada. In fact, the value of these interests represents more than 50% of the Company's total fixed investments. Our Company is, therefore, vitally interested in securing markets for Canadian produced oil. As a consequence, it plans to construct a plant for the refining of Canadian crude in Ontario as soon as the volume of its sales will warrant it. This should occur some time in 1961 or 1962.

Part I

MARKETING OF WESTERN CANADIAN CRUDE OIL

The problems of our crude producing industry cannot be separated from the pattern of oil production and consumption throughout the world.

The present economic recession in most industrialized countries has, temporarily, slowed down the rate of increase in petroleum demand. On the other hand, world productive capacity has expanded rapidly in recent years. This has brought about a surplus crude production which can only be absorbed gradually through increased world consumption.

From a long-term point of view, the most significant fact is that the world's known crude oil reserves are unevenly distributed, particularly in relation to the major centres of consumption.

Western Canada is, in our opinion, in an excellent position to benefit from the continued growth in North American petroleum requirements which other producing areas on this Continent will not be able to satisfy in the long run.

We believe that recent authoritative studies, such as the one published by the Royal Commission on Canada's Economic Prospects, have sufficiently proved this point. Consequently, we shall concern ourselves here primarily with the present position of the Canadian petroleum industry and its short-term, rather than long-term, prospects.

The position of the Canadian producing industry

Our crude producing industry has undergone a spectacular development during the last decade. Starting from the Prairie Provinces, it has expanded its markets to the Pacific Coast, into the United States and as far as Toronto in the East. Western Canada has experienced one of the most rapid rates of growth among the large producing areas in terms of crude oil production and penetration of markets.

This expansion has been achieved on a sound economic basis: the successive displacement of competitive sources of supply has resulted from the construction of large-scale transportation facilities and such wellhead price adjustments as appeared justified by the additional volumes gained.

In late 1956 and early 1957, the industry benefited from a temporary shortage situation created by the Suez crisis. Disregarding the influence which this had on the demand for Western Canadian crude, the major factor responsible for the reduced markets available since the last quarter of 1957 has been the economic recession in Canada and the United States, accompanied by a severe inventory reduction in the industry itself.

This condition, however, does not account entirely for the widening of the gap between actual and potential production in Western Canada which started in 1953. It appears that development of new production has been carried on upon the incorrect assumption that our markets would continue to expand at the exceptionally fast rate achieved in the earlier years.

The resultant over-expansion of production in relation to the available markets and the temporary adverse factors mentioned earlier have undoubtedly placed crude oil producers in Alberta in a difficult position.

Essentially, the problem is one of expanding the market for Western Canadian crude and gas to a level which will ensure continued sound growth for the producing industry. There are three main courses by which this can be achieved:

1st by the development of our natural economic markets

2nd by a reduction in the wellhead price of Western Canadian crude

3rd by the artificial expansion into domestic markets presently beyond the economic reach of Western Canadian crude.

Development of our natural economic markets

On this point there is no disagreement in the industry as to what should be done and must be done.

Dealing first with the Canadian markets, product imports into British Columbia and Ontario should be displaced as soon as possible and as

much as possible. This is within the power of the industry itself and programs have been instituted to achieve this objective.

New refining capacity under construction in the Vancouver area will displace a certain volume of product imports.

New refining capacity under construction and projected in Ontario will have the same effect in that very important market. This, together with the rapid increase in consumption expected in this densely populated and highly industrialized area and the consequent gradual elimination of products refined at Montreal will increase Western Canadian crude sales considerably.

As a result, we believe that total domestic demand for Western Canadian crude will reach a level of about 500,000 b/d by 1960 and 575,000 b/d by 1962.

When we deal with the export market, the problem is of a complex nature and its solution is not entirely within the power of the industry itself.

The United States has established a system of voluntary import quotas on crude oil in both major areas in which Canadian crude is sold: the Pacific Northwest and the Mid-West. So far, these quotas have had little effect on the movement of Western Canadian crude into the United States, partly because they were set at a relatively reasonable level and partly because the economic recession and the inventory liquidation had reduced the demand for crude oil in the areas affected.

There is a danger, however, that quotas may not be maintained in the future at a reasonable level and, in consequence, that refinery development in these areas may be retarded.

In order, first, to remove the uncertainty in this connection and, second, to ensure a treatment for Canadian crude which continental defence considerations as well as Canadian - U.S. trade relations fully justify, a high-level governmental approach to the United States appears necessary.

Extreme care must be exercised both by the industry and the Canadian Government that premature and precipitate action in our internal policies will not jeopardize a favourable outcome of such negotiations.

Under these circumstances, it is obviously difficult to forecast export demand. Perhaps the best that can be done is to assume that, with current restrictions continuing, a minimum of 120,000 b/d of Western Canadian crude will move into the United States over the next few years, and that, without restrictions, our export volume might reach 200,000 b/d in 1960 and 250,000 b/d in 1962.

With regard to gas exports to the United States, the matter is one that is largely in the hands of our Government. The industry is unanimous in the opinion that further exports of natural gas should be authorized without delay. The increased revenue which would accrue to producers in Alberta would have an immediate beneficial effect on the petroleum industry and the economy of the nation.

Reduction in the wellhead price of Western Canadian crude

The quickest and surest way of developing new markets would be to reduce the wellhead price of Western Canadian crude. However, everybody agrees that Canadian wellhead prices are already low when compared with those of similar crudes produced in the Western Hemisphere. Moreover, our crude replacement costs are expected to rise. Under these conditions, we cannot advocate the sharp immediate and probable future reductions in wellhead prices that would be necessary in order to acquire and keep new markets, such as the Montreal market.

Artificial expansion into domestic markets presently beyond the economic reach of Western Canadian crude

It has been suggested by some that the Montreal market should be economically accessible to Western Canadian crude were it not for the preference of the large international oil companies for using in the Montreal refineries of their Canadian subsidiaries and affiliates, low cost foreign crudes from politically unstable sources.

This accusation is not supported by evidence on hand which shows that the major oil companies in Canada, regardless of the affiliation of most of them with international companies, have done their utmost to expand the

markets for Western Canadian crude. The most evident proof is the capture of the Ontario market. If there had been any desire to discriminate against our Western crudes, the Ontario market could and would now be supplied by foreign crudes.

The completed, partially completed and projected expansion of refining capacity in Ontario by oil companies operating in the area, both independent and with international affiliations, proves beyond a shadow of doubt that those companies have done and are doing everything in their power to displace foreign crude with Canadian crude, wherever and whenever that is feasible.

Now, what are the facts with regard to the competitive position of Canadian crude in the Montreal area? In this connection, let us examine the case of Canadian Petrofina.

Canadian Petrofina refines in its Montreal refinery practically exclusively Kuwait crude. The posted price of this crude is $1.85 per barrel versus a posted price of $2.56 per barrel for Redwater crude. Admittedly Redwater crude is a more valuable crude than Kuwait, but Canadian Petrofina made a large investment in its refinery in order to be in a position to handle Kuwait crude and benefit from its low price. The investment in its refinery amounts to $1,750 per barrel of throughput as against $1,200 per barrel for an average refinery. This investment already has been made and must be written off regardless of the type of crude that is refined.

There is another factor that must be considered. Our choice of Kuwait crude with its high fuel oil content was made with due regard to market requirements in the Montreal area. A lighter crude with its higher gasoline potential yield would not fit the pattern of market requirements in that area.

So we start with a differential of 71¢ per barrel in the posted prices of these two crudes. This differential would be somewhat offset by lower potential transportation costs by pipeline from Edmonton to Montreal. There is a divergence of opinion as to the amount of this transportation saving, but under normal conditions this could not offset the differential in the cost of the two crudes.

As of today, with tanker time-charters available at no higher than USMC-55% and with the U.S. dollar at a discount of 3¾% in terms of Canadian currency, the differential in the laid-down cost of the two crude oils at Montreal would be 58¢ per barrel in favour of Kuwait crude. (See table, page 9.)

It is evident from the above that under present conditions the Montreal market lies outside the economic range of Western Canadian crude. The proposal, then, that import quotas on both crude oil and refined oils be imposed in order to make economically feasible the construction of a pipeline from Edmonton and to insure the use of Canadian crude by Montreal refiners is not put forward to combat the alleged preference for foreign crudes by Montreal refiners with international affiliations, but is an attempt to force the use of Canadian crude by those refiners regardless of the cost.

Let us consider, then, the effect of these proposals:

1. In order to eliminate effectively competition from foreign crude oils at Montreal, a system of import quotas and/or duties would be necessary. As the pipeline to Montreal would establish a long-term price and supply pattern in that area, such a system would have to be of more than a purely temporary nature and would have to be applied on imports of crude oil as well as refined products in the entire Eastern Canadian market. The Government would thus clearly acquire a major and possibly increasingly dominant role in directing the industry's affairs. Canadian Petrofina is firmly opposed to this.

2. As previously stated, Canadian wellhead prices are low compared with those of similar crudes produced in the Western Hemisphere. On the other hand, our crude replacement costs are expected to rise. As larger and more accessible markets will become available for Canadian crude in the future, unless quota restrictions were applied indefinitely, the industry would almost certainly suffer from the fact that it would be placed on a long-term basis of having its field prices of crude oil determined by competitive conditions at Montreal. This would be the penalty that we would incur by trying to cure by long-term measures a situation which basically stems from temporary causes. We do not believe this to be in our best interests as producers of crude oil.

COMPARATIVE CRUDE OIL COSTS

(Dollars per barrel)

Redwater (35° API)		Kuwait (31° API)	USMC — 40%	USMC — 50%	USMC — 55%	USMC — 60%
Posted Price (wellhead)	$ 2.56	Posted Price (f.o.b. Loading port)	$ 1.85	$ 1.85	$ 1.85	$ 1.85
Transportation to Edmonton	.08	Ocean transportation to Portland, Maine	1.06	.88	.80	.71
Pipeline tariff Edmonton-Montreal	.60	Marine & pipe-line loss	.03	.03	.03	.03
Pipeline loss	.03	Pipeline tariff Portland-Montreal	.11	.11	.11	.11
Laid-down cost at Montreal	$ 3.27*	Laid-down cost at Montreal (in US dollars)	$ 3.05	$ 2.87	$ 2.79	$ 2.70
		Equivalent in Canadian currency at 3¾% discount	$ 2.94	$ 2.76	$ 2.69	$ 2.60

*The delivered cost of $3.27 per barrel for Redwater crude does not take into account an additional charge of approximately 7c per barrel, representing amortization of the estimated loss resulting from the abandonment of the Portland-Montreal Pipeline.

3. As the competitive disadvantage of Western Canadian crude would not permit Montreal refiners to enter into long-term commitments, the Federal Government would either have to provide the necessary guarantees or participate directly in the financing and construction of the pipeline. Canadian Petrofina is opposed in principle to the invasion by the Government of a field which in our economic system belongs to private enterprise.

4. From the overall Canadian position, it would appear on the surface that elimination or curtailment of crude oil imports would be a boon to the Canadian economy by reducing our trade deficit. We must, however, take into consideration the fact that our adverse trade balance is largely a consequence of the heavy inflow of capital which has during recent years contributed to the country's rapid economic development. Factors, other than quantitative restrictions of Canadian imports will, in the normal course, tend to correct this imbalance. (This is fully borne out by our trade statistics for the current year as compared with 1957).

Any steps taken now to erect artificial barriers might well work to the disadvantage of Canada as a trading nation in general and as a crude oil exporter in particular.

The loss of dollars to the Sterling Area caused by the elimination of economically sound crude oil imports would not be conducive to the expansion of trade with that area.

The inevitable increase in energy costs to our industries in the Province of Quebec and the Ottawa-Cornwall area would certainly have an adverse effect on their ability to compete in world markets.

We wish also to reiterate that severe repercussions might occur in relation to our basic efforts to expand the U.S. markets for our crude.

5. If Montreal refiners were forced to use Canadian crude, they would have no alternative but to pass the increased cost on to the consumer in the form of increased product prices. As consumption of petroleum products in the area affected, i.e., the Province of Quebec and the Ottawa-Cornwall area runs close to 75 million barrels per year, this would, on the basis of the differential already mentioned, and present consumption, involve an increase of up to 44 million dollars per year in the cost of petroleum products to the ultimate consumer in those areas.

Such a price increase would undoubtedly have an adverse effect on the economy of those areas by adding to the costs of manufacturing, transportation and practically every other phase of economic activity.

Canadian Petrofina feels that it cannot give its support to any scheme that would have such far reaching effects on the welfare of its customers in the area in question.

6. It is also apparent that the proposed pipeline from Edmonton to Montreal would not be completed and in operation before 1961. As we have already intimated, there is clear evidence that the level of Canadian crude oil production will have been raised substantially by that time through the operation of normal business processes.

This means that the effects of an uneconomic project would begin to be felt only when the industry would, to a large extent, have overcome the difficulties which prompted that project.

CONCLUSION AS TO THE MARKETING OF WESTERN CANADIAN CRUDE OIL

The oil producing industry in Canada has enjoyed a period of rapid expansion, progress and prosperity. It is now faced with a period of re-adjustment.

It is significant that by far the largest section of the industry does not ask for any governmental help other than in areas where no other action is possible and where its own initiative cannot operate. It does not ask for governmental help because, presumably, it believes in private enterprise, and it does not believe it possible for private enterprise to continue to operate freely if it is not prepared to take its risks and solve its own problems. We contend that private enterprise cannot reasonably expect Governments to come to its rescue when times are bad and then allow it to operate freely again when times are good.

Admittedly we are going through hard times. A section of the industry feels the effects of these hard times more than the rest. Canadian Petrofina belongs to that section, but under no circumstances will it be a

party to the adoption of measures which, while providing temporary relief, are opposed both in principle and in fact to the long-term welfare of the company, of the industry and of Canada.

While refusing help where private enterprise and ingenuity should operate, we realize that there are areas where Government action can and should be effective.

We repeat that it is urgent and important that our Government authorize further exports of natural gas to the United States.

We also wish to emphasize that the Canadian Government should do all in its power to ensure that treatment for Canadian crude by the U.S. Government which continental defence considerations as well as Canadian-U.S. trade relations fully justify.

We also believe that a revision of our income tax laws ensuring a more equitable depletion allowance for Canadian producing companies is essential.

Finally, while not asking for such help ourselves, we would not object, if the Canadian Government feels that it is necessary and in the national interest to support the weaker members of the producing industry, to measures that would make available temporary financial assistance for those requiring it.

In conclusion, we affirm our belief that the natural development of our crude oil markets, aided by the measures suggested above, will ensure the continuing sound growth of our producing industry.

Part II

THE NATIONAL ENERGY AUTHORITY

We are not in favour of the proposal to establish a National Energy Authority for the following reasons:

1. We believe that every industry, and every sector of an industry, should be allowed to function with a minimum of interference on the part of governments. We think that government interference with the energy industries should be limited to what is necessary for the protection of the public interest. In our view, the public interest is adequately safeguarded by the existing authorities and we are not aware of any strong public sentiment to the contrary.

2. Our governmental authorities already have wide regulatory powers in the fields of exploration, production and distribution of the various sources of energy.

3. There exists today a sufficient number of agencies at all levels to exercise these powers. In our view, no useful purpose would be served by the creation of a further agency or authority to exercise some portion of the powers now in the hands of existing agencies.

4. It seems constitutionally impracticable to concentrate the existing powers — federal and provincial — in the hands of a single agency.

5. Official agencies have an inherent tendency to try continually to broaden their spheres of influence. Therefore, we consider that the creation of an additional board would inevitably and continuously increase the extent of governmental regulation of the industry. We do not consider such additional regulation to be in the best interests of the public in general or of the industry itself.

6. There is a serious danger that any new authority — created for a particular purpose and thought to be the direct consequence of the present inquiry — would prove to be an attractive medium for the use of

groups endeavouring to further the special interests either of a particular section of the country or of a particular segment of the industry. We do not consider this desirable.

7. The oil industry has certain characteristics which require that it attract to itself a continuous supply of risk capital. We think it is true to state that this type of capital tends to favour well-developed industries that are directed by private enterprise, and is reluctant to enter fields which are the subject of any material degree of state control. Moreover, the industry does not have the advantages or disadvantages of a captive market and must adapt itself to the ever changing conditions of supply and demand. It must be efficient to provide the consumer with the most suitable form of energy at the lowest possible cost, in line with world-wide competitive conditions. These and other characteristics require that the oil industry be granted the widest possible latitude within which to operate. We believe that the creation of an additional governmental authority would gradually restrict this necessary freedom of action of the industry and retard its growth.

In our view, the only real problem in this field is the need for a more precise delimitation of the limits of federal and provincial authority in the petroleum industry — particularly with regard to pipeline construction and operation. Nevertheless, we appreciate the difficult constitutional questions involved and merely underline this problem as one that will ultimately have to be dealt with by the federal and provincial legislatures. Once the limits of authority have thus been settled, the exercise of powers within each field will fall into the purview of the official bodies already existing, and that will suffice.